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Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

ON APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT

BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA

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With consent of the parties, the National Association of Manufacturers of the United States of America respectfully submits this brief as *amicus curiae* in support of Appellant's Jurisdictional Statement.

INTEREST OF THE AMICUS CURIAE

The National Association of Manufacturers of the United States of America (NAM) is a non-profit voluntary business organization organized as a membership corporation under the laws of the State of New York. It is composed

of more than 12,500 manufacturing and related concerns located throughout the United States. NAM's members represent a substantial proportion of the nation's industrial output and employ roughly eighty-five percent of all employees employed in manufacturing nationwide. The majority of these concerns engage in interstate commerce to some degree.

This case presents a fundamental and far-reaching issue. The extent of a state's power to tax corporations operating within that State, where the basis of the tax is income earned outside the state by independently operated out-of-state affiliates, is a substantial question under the Due Process and Commerce Clauses of the U.S. Constitution.

NAM's member companies are representative of that part of the nation's business sector which is most directly affected by state taxation, including corporate franchise taxes, upon multistate and interstate business operations. NAM is vitally interested in cases such as this which present significant constitutional issues affecting the uniformity, certainty and fair apportionment of taxes on income, or based on income, in each of the fifty states.

SUMMARY OF ARGUMENT

The result of the decision of the Court of Appeal of California in this case is that it allows California to impose a franchise tax upon Chase Brass and Copper Co. (Chase) measured by income earned by independent corporate affiliates of Chase, which income is in no way attributable to business operations within the State of California. It is, therefore, a tax based upon income earned outside the state. This Court has traditionally regarded such taxes as undue burdens upon interstate commerce under the Commerce Clause and violations of Due Process requirements.

The constitutional test established by this Court requires that a state tax on interstate enterprise may not be sustained where the tax reaches activities carried on beyond the borders of the state. Where a state income tax reaches

profits which are in no sense attributable to transactions within its jurisdiction, this Court has held the tax to be constitutionally invalid. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931); *Norfolk & Western R. Co.* v. *Missouri,* 390 U.S. 317 (1968).

Compounding of tax obligations results where some states practice the unitary apportionment method because other states do not allow the taxpayer corresponding reductions in tax obligations. Single-state taxpayers thereby derive an unfair competitive advantage over multistate taxpayers who are thus burdened because of their interstate commerce activities.

ARGUMENT

I. The Due Process and Commerce Clauses Protect Multistate Taxpayers From Tax Apportionment Schemes Which Result in "Palpably Disproportionate Results."

This Court has regularly applied the Due Process Clause of the Fourteenth Amendment to the U. S. Constitution so as to prevent the taxation by one state of property located in another state. *Frick* v. *Pennsylvania,* 268 U.S. 473 (1925); *Looney* v. *Crane Co.,* 245 U.S. 178 (1917); *Delaware, L & W.R. Co.* v. *Pennsylvania,* 198 U.S. 341 (1905). The Due Process Clause has often been satisfied where apportionment taxation methods were appropriate and not an undue burden on interstate comerce. *Pullman's Palace Car Co.* v. *Pennsylvania,* 141 U.S. 18 (1891); *Union Refrigerator Transit Co.* v. *Lynch,* 177 U.S. 149 (1900). The Due Process Clause may also allow the reasonable use of unitary apportionment as an acceptable taxation procedure "[u]nless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege." *International Harvester Co.* v. *Evatt,* 329 U.S. 416, 422-423 (1947).

This long history of constitutional controls over interstate taxation methods has applied equally to income as well as real and personal property. *Hans Rees' Sons* v.

North Carolina, 283 U.S. 123 (1931); *Norfolk & Western R. Co.* v. *Missouri*, 390 U.S. 317 (1968). A franchise tax determined by income is not distinct from a tax on income because tax questions are determined on matters of substance and not form. *See Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 120 (1920). The taxpayer carries the burden of showing that the income attributed to it under a state's apportionment formula is not reasonably attributed to business operations within the taxing state.

When applied to the factual circumstances presented in Chase, the unitary approach used by California produced such a disproportionate result that Chase was taxed on an apportioned national net income of $102,627,592 for 1955 when, in fact, Chase actually lost $2,370,010 that year due to a flood of its major processing plant. Further, for the three years in question, the California unitary apportionment approach derived inflated net income to sales ratios of 38%, 51% and 58%. These results, discussed and documented in Appellant's Jurisdictional Statement, are patently absurd.

Clearly, the apportioned net income amounts attributed to Chase and taxed under the California unitary formula are usurped by California from Chase's independent corporate affiliates. Even though they do no business in California, California reaches its tax arm into interstate commerce and taxes the affiliates' property, in the form of ~~their~~ their income. The gross exaggerations of Chase's income produced by the California scheme cannot be excused under the "rough approximation" language of *International Harvester* (*Supra* at 120) relied upon by the court below. Chase's attributed income under California's unitary apportionment scheme simply cannot be reasonably attributed to Chase's operations in California.

It is the opinion of the *amicus curiae* that the California unitary apportionment method of determining state franchise taxes simply will not withstand the scrutiny of this Court.

II. If Left Unchecked, The Undue Burden on Interstate Commerce of Unitary Apportionment Will Compound Taxation of Multistate Corporations, to the Competitive Advantage of Single-State Enterprises.

The potential effect of the Chase decision extends to all state and local government taxing jurisdictions by encouraging them to adopt this approach as a means to supplement failing tax revenues.

The full extent of California's burden upon interstate commerce imposed by the decision in this case will be substantially compounded by the often discriminatory taxation of multistate enterprises. While California in this case has treated a multicorporate enterprise on a unitary basis so as to increase the taxpayer's tax obligation in California, other states have refused to allow the same taxpayer a corresponding reduction in their tax obligation in those states. *See Kennecott Copper Co.* v. *State Tax Comm.*, 118 Utah 140, 221 P. 2d 857 (1950); *Kennecott Copper Corp.* v. *State Tax Comm.*, 5 Utah 2d 306, 301 P. 2d 562 (1956). Single-state taxpayers will derive an unfair competitive advantage for they will not be encumbered with such taxes.

The problem of compounding tax obligations was specifically noted by the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the U.S. House of Representatives. That committee noted that "the present 'unitary business' rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole." H.R. Rep. No. 952, Vol. 4, p. 1155, 89th Cong., 1st Sess. (1965). The report goes on to state that the establishment of a national standard in this area "will result in a significant measure of relief from the multiplicity and diversity of the present system." *Id.* at 1205-06.

In its study of this problem the House's special subcommittee actually anticipated the need for this Court's ultimate

resolution of the many substantial questions and uncertainties in this area when it stated:

> First of all, the [unitary business or combined report] concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. This may arise as a constitutional question or in terms of the limitations of State taxing power . . .

H.R. Rep. No. 1480, Vol. 1, p. 245, 88th Cong., 2d Sess. (1964).

The serious constitutional problems concerning state taxation of multicorporate enterprises have not been resolved by the Congress. The issues can be resolved only by this Court. The courts of the several States will be frequently confronted with cases involving these same federal issues. Without this Court's guidance, a widening disagreement over the existence of constitutional restraints on the States' power to tax multistate business enterprises will certainly result.

Unless this Court reverses the decision below, the orderly growth of national commerce will be impeded. Unfair apportionment of revenue among the states will logically follow. Interstate commerce will be burdened with compounded taxes which will have the full effect of tariff barriers between states. Moreover, the magnitude of these problems will inevitably increase as state revenue needs grow.

CONCLUSION

It is respectfully submitted that the Chase case reflects an arbitrary extension of state taxing authority in direct contravention of established constitutional limitations. The case affords the basis for a needed reaffirmation by this Court of the limitations on the power of a state to base a tax on income derived outside its borders.

The decision of the court below must be reversed.

Respectfully submitted,

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